POSITION PAPER

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Financing key enablers of the green transition: Orgalim position on the EU taxonomy for sustainable activities

Executive summary

Orgalim, representing Europe's technology industries, welcomes the European Commission's efforts in shaping the EU taxonomy framework and redirecting capital flows towards economic activities leading to a sustainable and climate-neutral Europe. The uptake of a wide range of technologies, systems and services is a key factor for achieving the ambitious climate and sustainability goals in the European Union and beyond. Therefore, the taxonomy framework should reflect the fact that our technologies and their manufacturing processes are key enablers of the green transformation of the economy and society.

In this paper, we ask EU policymakers engaged in developing the taxonomy framework to:

- Acknowledge Europe's technology industries as enablers for a sustainable future;
- Ensure that taxonomy encourages innovation and competitiveness;
- Improve governance and transparency;
- Keep reporting cost-effective;
- Make taxonomy more inclusive;
- Guarantee the continuous flow of international capital.

1. Introduction

European technology manufacturers offer innovative technology solutions that will help the transition to a more competitive, resource-efficient and climate-neutral economy by 2050 – the key goal of the European Green Deal. Besides the already available cutting-edge technologies, a substantial amount of financing is still needed for greening different sectors of the economy. The EU will need around €470 billion per year of investments[1] to reach its 2030 climate and environmental policy goals. Part of these investments should be directed towards the uptake of a wide range of technologies, systems and services, which is a key factor for achieving the ambitious climate and sustainability goals in the EU and beyond.

In this context, Orgalim, representing the mechanical engineering, electrical engineering and electronics, and metal technology branches, welcomes the Commission's efforts in shaping the EU taxonomy framework to help bridge the huge investment gaps that currently exist. The EU Taxonomy Regulation (EU/2020/852), at the heart of the EU's sustainable finance agenda, can further incentivise financial flows towards economic sectors and activities in line with the climate change and environmental objectives, provided the legislation is properly designed and implemented.

It is crucial that the manufacturing of a wide range of state-of-the-art technologies, systems and services, as well as their enabling role in a sustainable future, is fully recognised and reflected in the Taxonomy Regulation and its secondary legislation. This would turn the implementation of taxonomy's framework into an opportunity to reaffirm the technology industries as sustainability leaders both in Europe and worldwide, particularly in the context of recovery from the economic impact of the COVID-19 pandemic.

2. Ensuring a more workable and inclusive taxonomy framework

The pace and scale of the transition will require strong financial support of not only technologies, but also their manufacturing processes. That is why the taxonomy should redirect much needed private capital into both technologies and the economic activities that produce them, while rewarding and encouraging **innovation** and **competitiveness**.

With regard to **innovation**, the taxonomy should be responsive to rapid innovation and technological developments. The update of taxonomy delegated acts must keep up with innovation to timely accommodate new and emerging technologies and additional economic activities in the future. This is important as there is a risk of creating an additional hurdle for financing emerging technologies and start-ups, which may not be labelled as sustainable simply because they are at a very early stage of development. In general, investors have high risk perception when financing new technologies and start-ups, which may be even higher if these are not considered as taxonomy-aligned. According to the Climate Delegated Act, companies' investment in R&I can count as taxonomy-aligned, which is a positive development. This should also be also reflected in future delegated acts, such as the environmental one.

For industry to keep its **competitive edge** while being sustainable, the taxonomy should integrate the latest industry experience. It must also respect the principle of **technology neutrality** as laid out in Article 19. This principle must be embedded in technical screening criteria to ensure a level playing field among various sustainable technologies and processes. When setting the secondary legislation, such as technical screening criteria, the impact on both environmental performance as well as short- and long-term competitiveness should be considered and communicated to relevant stakeholders, including industry. This would lead to greater confidence and understanding of the scale of transition ahead.

Companies' ability to raise, and continue attracting, both public and private capital under favourable terms will remain key to shaping EU competitiveness. By labelling certain economic activities as sustainable, while leaving others out of its

[1] European Commission, Staff Working Document: Identifying Europe's Recovery Needs, 27 May 2020

scope, the taxonomy will affect **private capital flows** on the market. In addition, the ongoing trends demonstrate that the taxonomy will have an impact **beyond private capital**. A clear reference to the taxonomy or its 'do no significant harm' principle is introduced for various public financial instruments, such as the Recovery and Resilience Facility[2]., the InvestEU programme, Horizon Europe, EIB investments, public procurement, export financing and the ongoing revision of environmental and energy state aid rules[3]

Given that it is also likely to have an effect on public capital, it is paramount that the taxonomy, including the technical screening criteria, is further adjusted and improved before being used as a reference in wider policymaking. The issue is that the technical screening criteria, as currently defined, are only supporting a best-in-a-class approach, that would allow only a very small portion of activities to be financed, which is according to some estimates only 0.1% of activities. This should be urgently corrected to make sure we are moving in the right direction to finance our transition.

2.1. Better governance and transparency

Better **governance** and **transparency** on the taxonomy, particularly regarding the ongoing work on its secondary legislation, would be part of the solution. The secondary legislation must be developed in a transparent, inclusive and predictable way. Given that the taxonomy is about contributing to the EU's long-term goals by 2050, it is unusual that the timeframe for the process of drafting key deliverables for the taxonomy's secondary legislation is extremely tight. For the taxonomy to work best in practice, it is important to gather well-considered and substantiated input from all stakeholders impacted. This requires more time than the consultations conducted by the Commission and its advisory bodies currently envisage.

In addition, a thorough impact assessment on the technical screening criteria would contribute to better governance and transparency. More transparency regarding the Commission's advisory bodies, such as the EU Member States expert group on sustainable finance and the Sustainable Finance Platform would be highly welcomed. The latter should involve more experts, representing economic actors who will be impacted in the first place. Increased transparency, such as document sharing, and involvement of stakeholders would facilitate a better understanding and implementation of the taxonomy. Additionally, transparency on the expected timeline of assessing the criteria and new activities would provide a certain level of predictability and a positive signal to the market (Articles 19.5 and 26.b).

The Taxonomy Regulation and its secondary legislation should be in line with Article 290 of the Treaty on the functioning of the EU as well as the Commission Guidelines on Better Regulation[4]. With regard to the latter, the taxonomy should meet the policy goal of steering capital flows at minimum cost, including that related to the financial and administrative impact of the proposal. This issue brings us to **reporting obligations**.

2.2. Cost effective reporting by companies

According to Article 8 of the Taxonomy Regulation, **companies that fall under the scope of the Non-financial Reporting Directive (NFRD)** are required to disclose information on taxonomy alignment. Given that a new proposal for revising the NFRD, recently renamed as the Corporate Sustainability Reporting Directive (CSRD), aims to broaden the scope to include all large companies without the 500 employees threshold and explicitly include listed SMEs, it is important that both pieces of legislation provide proper incentives without creating an impediment to the economic growth of companies, especially (smaller) SMEs.

The level of detail for calculating and disclosing taxonomy alignment in relation to turnover and expenditures (CapEx/OpEx) is defined in a separate delegated act under Article 8 of the Taxonomy Regulation. The Commission adopted this delegated act in July 2021. While Orgalim supports a closer link between financial and sustainability

[2] European Commission, Staff working document - Guidance to Member States Recovery and Resilience Plans, 22 January 2021
[3] European Commission, Impact assessment for revising the Guidelines on state aid for environmental protection and energy 2014-2020 (2014/C 200/01) and the proposed revised Climate, Energy and Environmental State Guidelines as of 7 June 2021.
[4] European Commission, Staff working document-Guidelines on Better Regulation, 7 July 2017

reporting, it is important that the reporting obligations linked to the taxonomy serve as a real driver for sustainable development without creating an unnecessary administrative burden and additional costs. Proper consideration should therefore be given to the accuracy required in the reporting. The need for accuracy should be balanced against a principle of cost-effective reporting. For instance, companies should only be required to disclose taxonomy data for turnover and CapEx/OpEx when the relevant economic activity is claimed to be taxonomy-compliant.

Furthermore, the requirement to publish key indicators over a five-year period should not be applied retroactively due to the absence of historical data and should therefore start from 2022. This would allow investors to have an overview of accurate data and the progress companies are making on transitioning towards a more sustainable portfolio. Also, as the reporting obligations for the first delegated act on climate mitigation and climate adaptation will come into force on 1 January 2022, the Commission should allow for a phase-in period, particularly with regard to Do No Significant Harm (DNSH) disclosure. It is broadly recognised that DNSH data will, in many cases, be extremely difficult to collect and report on.

While the scope of taxonomy disclosure by corporates will be limited to companies of a certain size, SMEs might be asked in the future to provide taxonomy-related information to their business costumers further up the value chain. Hence, while the reporting by SMEs should remain strictly voluntary, they would benefit from a simplified reporting standard for SMEs. SMEs should remain excluded from mandatory reporting, which should be reflected in the delegated acts on Articles 5, 6 and 8 as well as in the Corporate Sustainability Reporting Directive. To enable more cost-efficient reporting, the EU should provide additional support via freely available tools, database and calculation systems, and avoid external costs, e.g. third party certification.

Many companies are likely to get a low 'taxonomy score' simply because their sector is not presently covered by the taxonomy, or because they operate in an environmentally 'neutral' space, where a substantial contribution to the environmental objectives of the taxonomy is not possible. However, these companies might not cause any harm to the environment. It is paramount that this group of companies is not unjustly penalised in their access to capital. It is therefore important that the reporting framework of the taxonomy provides a tool with which such companies can communicate to the financial markets that they conduct their business in a taxonomy-neutral manner.

2.3. Need for transition finance

In its current form, the taxonomy is based on a binary approach of defining what is and what is not 'green'. It recognises as 'sustainable' economic activities that substantially contribute to one of the six environmental objectives[5] or that enable other activities to make such a substantial contribution. As a result, few companies will be fully taxonomy-aligned, meaning that their activities will be labelled as **substantially contributing** to/or **enabling** environmental sustainability.

The Commission, and its Sustainable Finance Platform, are exploring other ideas such as transition financing, in an effort to create a more inclusive taxonomy. Orgalim welcomes the ongoing work on transition financing necessary for the process of 'greening' the economy. We need to recognise the efforts of companies committed to making improvements to their environmental footprint and in the transition to net-zero by 2050.

Investments in companies' projects towards the attainment of the technical screening criteria should be considered as taxonomy-aligned, provided they are incorporated in a dedicated long-term investment plan with a determined time frame of up to ten years. Such transition plans would attract financial institutions that wish to increase their share of a green portfolio, while positively impacting companies' competitiveness.

The taxonomy regulation currently provides a solid legal basis in Article 10.2 which defines transitional activities for climate-related objectives. Orgalim believes, however, that this is not adequately reflected in the current discussions

[5] Environmental objectives are 1) climate change mitigation, 2) climate change adaptation, 3) sustainable use and protection of water and marine resources, 4) transition to a circular economy, waste prevention and recycling 5) pollution prevention and control, 6) protection of healthy ecosystems.

regarding the delegated acts. The criteria so far have not properly reflected that transitional activities provide a huge potential to reduce carbon emissions. As a consequence, proven technologies such as the use of renewable and low-carbon fuels would not be considered sustainable, even if the Commission in other areas of its work integrates exactly the same technologies into their future policy strategies. The Commission should make better use of Article 19 which explicitly states that transitional activities (10.2) should be considered when setting the taxonomy technical screening criteria in delegated acts. In the future revision of the taxonomy, a discussion needs to take place to ensure that transitional activities are also defined for other environmental objectives such as water, pollution prevention and the circular economy.

2.4. Upcoming delegated acts on sustainable activities: lessons learnt

The EU Taxonomy is an evolving framework. Since the regulation entered into force in July 2020, the Commission, together with advisory bodies, has embarked on the demanding process of identifying sustainable activities.

The Commission adopted a first concrete list of sustainable activities contributing to climate mitigation and adaptation on 4 June 2021, now known as the Climate Delegated Act. Following the very high interest and substantial input received from various stakeholders once the draft and final version of the act was made publicly available, the Commission has committed to adopt complementary climate delegated acts on nuclear, gas and manufacturing later in 2021 in efforts to address some concerns raised during the consultation period. Orgalim welcomes the Commission's intention to complement the current version of the climate act, which does not include a number of manufacturing activities that significantly contribute to reaching Europe's climate goals.

In line with the instrument of transitional activities as foreseen in the taxonomy regulation, the evaluation of gas-based technologies should include the immediate positive effects on GHG reductions when replacing coal, the contribution of dispatchable power generation to a resilient power system and the transition from natural gas to using renewable climate-neutral gases along with the growing availability of these gases. While the transitional nature of such technologies should be recognised in corresponding secondary legislation in the medium-term, the long-term target (i.e. after 2030) should foresee the use of climate-neutral fuels only.

Additionally, the Commission is expected to adopt the environmental delegated act, listing activities contributing to the good status of water, biodiversity protection, circular economy and pollution reduction and prevention, by 31 December 2021.

In this subsection Orgalim would like to stress the recommendations for the upcoming delegated acts on sustainable activities. These recommendations are based on the earlier position of Orgalim on the Climate Delegated Act[6] and our ongoing engagement in the Sustainable Finance Platform[7].

The taxonomy is currently focused on single economic activities and as such it could fail to recognise the potential of **horizontally linked economic activities** that contribute to the Green Deal objectives. This has been particularly the case for the digital transformation and automation processes of many sectors and their potential to reduce carbon emissions, which have not been properly recognised in the climate delegated acts. The same applies to services linked to products, which, besides the carbon reduction potential, can extend the lifetime of products through maintenance.

Creating more enabling activities to recognise activities of horizontal relevance for different sectors, such as **advanced manufacturing**, would recognise and unlock their potential to decarbonise the entire economy. Orgalim calls for **the potential of a horizontal approach to activities to be considered in the upcoming delegated acts and the regulation's revision.**

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[6] For more information, see Orgalim comments on the 1st draft delegated act on climate change sustainable activities supplementing the EU Taxonomy Regulation, 18 December 2020, accessible here.

[7] Orgalim has been an active member of the Sustainable Finance Platform since the launch of its work in mid-October 2020.

Furthermore, creating the right enabling criteria is highly important. For example, regarding the circular economy, producing new parts from recycled or bio-based material requires machines for sorting collected waste. These machines in turn need high quality sensors to sort waste. Manufacturing of this machinery should also be listed in the taxonomy to encourage the development of advanced technology. An additional complication to be considered is that a machine which is able to process recycled/bio-based material can also be used for processing new material into single-use products. Especially for the circular economy, it is often a complete value chain involving suppliers and customers that decides about the sustainability. Each involved activity contributing to sustainability should benefit from the taxonomy. However, defining technical screening criteria is very difficult with the current methodology. The **enabling criteria** should be flexible and easily manageable, while strict thresholds cannot be applied to all individual projects.

Technology providers produce advanced energy efficient and circular products and technologies which contribute to environmental sustainability, including the green transformation of other sectors. They are often **tailored to the specific needs** of their customers and therefore are not comparable to other best performing technologies or solutions. The Commission should take this specificity into account when setting the technical screening criteria for manufacturing technologies and their key components.

In the climate change delegated acts, many technologies were listed in the end-use segments (as directly substantially contributing to climate objectives) but not properly reflected in the manufacturing section. Building from this experience, it is paramount to maintain consistency in the delegated act and qualify all technologies allowing end-segments as enablers in the manufacturing section. This can be achieved with an automatic eligibility criterion for technologies delivering climate and environmental benefits.

Lastly, the taxonomy should not disqualify sustainable activities and green technologies based on how the customer might use them. For example, a sorting machine for recycling can be used also in mining. The technical screening criteria should be developed in a way to decouple a technology criterion (the technology's design) from an end-segment criterion (the final use of the technology). The taxonomy must include a wide range of economic activities and reward activities, which are environmental frontrunners within their branches. Additionally, for our companies it could be very difficult to track who the end-user might be.

2.5. Broadening the EU taxonomy: neutral, harmful and social taxonomy

According to Article 26, the Commission will assess by 31 December 2021 how to extend the scope of the Taxonomy Regulation beyond the green taxonomy to;

1. "No significant impact economic activities" or neutral taxonomy;
2. "Significant harm economic activities" or brown taxonomy and
3. Social taxonomy covering other sustainability objectives, such as social objectives.

We support the taxonomy's positive incentive logic. Therefore, any new ideas considered for extending the taxonomy to other categories of economic activities as outlined in Article 26 should follow that logic and make the taxonomy more workable for industry.

N**o significant impact criterion** would be key for companies to communicate to the financial markets that, while they might not substantially contribute, their economic activities do not have a significant impact on environmental sustainability either. This new criterion would make companies' reporting more trustworthy for financial institutions.

A possible new **significant harm criterion** could pose a risk to labelling companies' activities as causing significant harm to the environment. Any negative list that excludes specific technologies from access to finance would only penalise companies, further limiting their capacity to invest in greening their assets. Therefore, we would be critical about identifying additional significantly harmful activities or requiring their decommissioning. We recommend a recognition that transition from significant harm to significant contribution can be recognised as taxonomy-aligned in a future taxonomy framework.

Furthermore, the Commission is exploring possible ways to extend the taxonomy to **social sustainability**. Social sustainability is understood to cover areas such as human rights and labour rights, but also social corporate governance and due diligence. While the concept of a social taxonomy might have merit, it is paramount that, if decided upon, it is established as a separate tool to the 'green' taxonomy. This is with a view to not hindering access to sustainable finance for the green transition. We nevertheless question the reason for including corporate governance and due diligence in a social taxonomy, as these areas are already considered to be covered in Environmental, Social and Governance (ESG) rating.

3. EU taxonomy from a global perspective

The EU is the first to set up a legal single classification system worldwide, which replaces various voluntary financial taxonomies. The EU taxonomy regulation gives Europe a first mover advantage, with spillover effects on the global stage. As such it sets a gold taxonomy standard, without competition for the time being.

The advantage of the taxonomy as a tool that eliminates the risk for greenwashing is that foreign investors are likely to be drawn to the EU to increase their share of green portfolios. The downside is that only the investing firms with enough resources to comply with strict reporting requirements as stipulated in Articles 5,6 and 7 would be able to offer their products in Europe. Another concern is that the technical screening criteria indirectly make it more attractive for global investors to turn to other regions with their investments. All this could create a risk of investment leakage. Since EU companies continue to need international investments for global competitiveness and for the green transition, the EU **Taxonomy must not create competitive disadvantages for European companies** and investors vis-à-vis other financial markets and must not lead to investments being withdrawn from Europe. The issue is becoming of even greater importance given that various international bodies have joined forces to compete with the EU gold taxonomy standard and create a transnational ESG framework and standard.

Since the taxonomy has been elevated on the global agenda and is discussed at different multilateral and bilateral fora, we call for the taxonomy to be further addressed at the International Platform on Sustainable Finance, the EU-US Joint Regulatory Forum, G20 and G7 meetings and the upcoming COP 26 conference in November 2021. The EU has the possibility to lead in the area of sustainable finance. As many third countries are going to develop their own taxonomy, the EU should seek to develop an agile and operational framework to inspire other parts of the world and promote convergence at global level.

Orgalim and our industries stand ready to guide and support these discussions with EU policymakers to make the taxonomy a success story in the EU and beyond.

Orgalim represents Europe's technology industries, comprised of 770,000 innovative companies spanning the mechanical engineering, electrical engineering, electronics, ICT and metal technology branches. Together they represent the EU's largest manufacturing sector, generating annual turnover of €2,126 billion, manufacturing one-third of all European exports and providing 11.33 million direct jobs. Orgalim is registered under the European Union Transparency Register – ID number: 20210641335-88.

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